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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

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In the Matter of)	
)	
Bell Atlantic Telephone Companies)	Transmittal Nos. 741, 786
)	
Revisions to Tariff F.C.C. No. 10)	CC Docket No. 95-145

**OPPOSITION OF ADELPHIA COMMUNICATIONS CORP.
TO BELL ATLANTIC'S DIRECT CASE**

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SUMMARY

In this investigation of Bell Atlantic's video dialtone tariff, the Commission finally must decide who will pay for the fiber-to-the-curb video delivery network Bell Atlantic is building in Dover Township, New Jersey. At the rates proposed by Bell Atlantic, the lion's share of the costs of this *video* facility will be assigned to *telephone* services. Bell Atlantic's direct case provides no justification for placing this substantial burden on telephone ratepayers. Accordingly, Bell Atlantic's rates are unreasonable and the Commission must prescribe cost allocation procedures and overhead loading factors that produce just and reasonable rates.

As an initial matter, Bell Atlantic seeks to avoid scrutiny of its cost allocation proposals by arguing that the Commission has no authority to consider whether other allocation methodologies might be preferable to the one proposed by Bell Atlantic. This position plainly is at odds with the Communications Act and Commission precedent, both of which unambiguously support the Commission's authority to prescribe rates and practices in the context of a tariff investigation. Moreover, the Commission's authority to prescribe cost allocation procedures is particularly strong in this case, where the Commission repeatedly deferred consideration of cost allocation issues in rulemaking and Section 214 proceedings on the grounds that these issues were more appropriately considered during tariff review.

The critical issue in this investigation, and in video dialtone regulation generally, is how to allocate the common costs of facilities used to provide video and telephone service. Bell Atlantic's proposal would allocate to telephone customers an amount far in excess of the cost of an entirely new stand-alone telephone network. Nothing in Bell Atlantic's direct

case, or any of its other filings, explains what benefits telephone customers would receive from the fiber-to-the-curb network that possibly justify this allocation. Consequently, the Commission should not permit Bell Atlantic to allocate to telephone services any amount in excess of the cost of a new stand-alone telephone system.

Bell Atlantic's proposed overhead loadings are similarly flawed. Bell Atlantic treats overhead as a fixed cost to be allocated on an arbitrary basis among all its services. This treatment is plainly erroneous because overhead costs vary with direct costs. Bell Atlantic can be expected to incur at least 65 cents of overhead for each dollar of direct video dialtone cost, and this 65 percent loading factor is the minimum that must be applied to prevent subsidization of Bell Atlantic's video network at the expense of telephone customers.

The Commission must address these concerns by prescribing more reasonable allocation procedures and overhead loadings because state and federal price cap rules will not prevent Bell Atlantic from passing the costs of the Dover facility to its captive telephone ratepayers. Because Bell Atlantic's costs still affect its rates for regulated telephone services, Bell Atlantic has the incentive and the ability to shift costs from video dialtone service to non-competitive telephone services.

Bell Atlantic's argument that a change in allocation and overhead procedures would cause it to lose video dialtone customers does nothing to support its unreasonable proposals. Rather, it demonstrates the fact that Bell Atlantic has made an uneconomic investment in a facility that cannot generate sufficient revenues to cover its cost. If the Commission allows Bell Atlantic to shift the risk of this investment from Bell Atlantic's shareholders to its ratepayers, it will encourage other LECs to make similarly ill-advised investments.

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**OPPOSITION OF ADELPHIA COMMUNICATIONS CORP.
TO BELL ATLANTIC'S DIRECT CASE**

Adelphia Communications Corporation ("Adelphia"), by its attorneys, hereby submits its Opposition to the Direct Case submitted by Bell Atlantic in the above-referenced tariff investigation.^{1/} The rates proposed by Bell Atlantic violate Section 201(b) of the Communications Act of 1934, 47 U.S.C. § 201(b), because they are based on an unsupported and unreasonable allocation of costs between video and telephone services. Accordingly, the tariff is unlawful and the Commission must prescribe cost allocation procedures and overhead loading factors that produce just and reasonable rates.

I. INTRODUCTION

Sixteen months after initially granting Bell Atlantic authority to build a fiber-to-the-curb video delivery network in Dover Township, New Jersey, the Commission now must decide the critical question of who will actually pay for these facilities. Bell Atlantic has proposed to allocate 72 percent of the direct costs of the Dover facility to *telephone* services, without *any* explanation of the benefits telephone customers will receive from the new facility that would not be available from a less expensive upgrade of the existing network. Under

^{1/} *Bell Atlantic Telephone Cos. (Revisions to Tariff F.C.C. No. 10)*, CC Docket No. 95-145, Bell Atlantic Direct Case (filed October 26, 1995) ("Direct Case").

this proposal, Bell Atlantic plans to force captive telephone customers to pay the lion's share of the cost of this network rebuild. Adelphia will demonstrate here, as it has previously,^{2/} that Bell Atlantic's plan violates the Act and is bad public policy.

The critical issue in this case is the allocation of common costs and overhead between video and telephone services. The Commission, not Bell Atlantic, must decide the appropriate allocation of the costs of the Dover facility. The Commission cannot abdicate its statutory responsibility to make this critical public policy decision and simply rubber stamp Bell Atlantic's unreasonable and unsupportable proposal.

The Commission cannot lose sight of the significance this decision will have on telephone ratepayers throughout the country. In addition to deciding how the costs of Bell Atlantic's Dover facility will be allocated, this proceeding also will establish precedent that will guide the investment decisions of other local exchange carriers. If LECs are permitted to immunize their shareholders from the risk of entering the video market by allocating costs to telephone services, the potential for uneconomic investments is enormous. Thus, the Commission must follow through on its commitment to implement video dialtone "in a manner that does not subject basic telephone ratepayers to unreasonable increases or to allow improper cross-subsidization."^{3/}

^{2/} *Application of New Jersey Bell Telephone Company*, W-P-C 6840, Petition to Deny of Adelphia Communications Corp. (filed January 22, 1993) ("Petition to Deny"); *Bell Atlantic Telephone Cos. (Revisions to Tariff F.C.C. No. 10)*, Transmittal No. 741, Petition to Reject of Adelphia Communications Corp., *et al.* (filed February 21, 1995).

^{3/} *Telephone Company-Cable Television Cross-Ownership Rules*, Memorandum Opinion and Order on Reconsideration and Third Further Notice of Proposed Rulemaking, 10 FCC Rcd 244,322 (1994) ("*Video Dialtone Reconsideration Order*").

As described in the attached declaration of Dr. Leland Johnson (the "Johnson Declaration"), Bell Atlantic has utterly failed to demonstrate that its proposed allocation of common costs and overhead is reasonable^{4/}. Obviously, the motivation underlying Bell Atlantic's network rebuild is its desire to provide *video* services. Bell Atlantic asserts that telephone customers will derive some benefit from the fiber-to-the-curb network it is building in Dover; however, it has failed to identify these benefits, much less quantify them, or explain why they could not be achieved with a less expensive upgrade of the Dover telephone network. Bell Atlantic's total silence on this critical issue confirms that its fiber-to-the-curb facility would not be built but for Bell Atlantic's entry into the video market. The Commission cannot ignore Bell Atlantic's tremendous incentive and ability to facilitate this entry by allocating the bulk of the costs of the Dover network to telephone customers, or the inadequacy of state and federal price cap rules to protect telephone ratepayers from this cross-subsidization.

The Commission must require Bell Atlantic to face the fact that *video* customers should pay for the network built to benefit them. Bell Atlantic knew when it constructed its facilities that the Commission had not approved its cost allocation plan and that it could be required by the Commission to recover from video dialtone customers a greater percentage of costs than originally proposed.^{5/} If Bell Atlantic cannot recover the cost of the video dialtone

^{4/} "I conclude that costs should be reassigned, with at least twice as much investment assigned to video dialtone as the amount now reflected in Bell Atlantic's video dialtone tariff." Johnson Declaration at 3.

^{5/} Indeed, although Bell Atlantic's tariff relies on a 28 percent allocation to video dialtone, Bell Atlantic originally told the Commission that an estimated "40-50% of the costs

system from video dialtone customers, its telephone customers must not be forced to suffer the loss. Telephone customers should not be insurers of Bell Atlantic's commercial success in this new business venture and they should not be required to bear the cost of Bell Atlantic's unreasonable and unlawful proposal.

II. THE COMMISSION MUST CRITICALLY EXAMINE BELL ATLANTIC'S PROPOSED ALLOCATION OF COMMON COSTS.

The Commission explicitly recognized in the *Video Dialtone Reconsideration Order* that "LECs may have an incentive to understate the direct costs of the service in order to set unreasonably low prices and engage in cross-subsidization."^{6/} To limit this potential for anticompetitive pricing of video dialtone, the Commission required LECs to demonstrate that their video dialtone tariff filings satisfied the price cap "new services" test. Under this test, the revenues produced at the proposed rates must recover direct costs (including a reasonable portion of shared or common costs) plus a reasonable portion of overhead.

The critical regulatory issue in this investigation is what constitutes a reasonable allocation of common costs between video and telephone services. In deciding how to allocate the costs of LEC network rebuilds necessary to provide video services, the Commission must fulfill its statutory responsibility to protect ratepayers and competitors of

of the system will be assigned to video dialtone services." *New Jersey Bell Telephone Co.*, Order and Authorization, 9 FCC Rcd 3677, 3679 (1994) ("*Dover Order*"), *appeal pending*, *Adelphia Communications Corp. v. FCC*, Case No. 94-1616 (D.C. Cir. Sept. 7, 1994).

^{6/} *Video Dialtone Reconsideration Order*, 10 FCC Rcd at 344.

monopoly local exchange carriers. This statutory obligation must temper any desire the Commission may have to promote infrastructure investment.

The Commission already has found that substantial questions of lawfulness exist by suspending Bell Atlantic's tariff. The burden, therefore, is on Bell Atlantic to prove that its rates and the underlying cost allocations are lawful, not on the Commission to prove they are unlawful.^{7/} In its Direct Case, Bell Atlantic argues that the issue before the Commission is limited to whether Bell Atlantic's chosen cost allocation methodology is reasonable.^{8/} Bell Atlantic claims that the Commission has no authority to prescribe a different method of cost allocation, even if it finds that another method is preferable. By claiming that the Commission is able only to consider whether the methodologies proposed by Bell Atlantic are reasonable, Bell Atlantic is attempting to sharply limit the Commission's ability to use this proceeding to establish cost allocation rules for video dialtone providers.

Bell Atlantic's narrow framing of the issues is unsupportable. In determining whether Bell Atlantic has met its burden of proof, the Commission is *not* limited to considering whether Bell Atlantic's cost allocation methodology is reasonable on its face. If the Commission finds that allocation methods other than the one proposed by Bell Atlantic are

^{7/} Section 204(a)(1) of the Act provides that when the Commission suspends a new or revised charge, "the burden of proof to show that the new or revised charge . . . is just and reasonable shall be upon the carrier." 47 U.S.C. § 204(a)(1). Commission precedent confirms that carriers bear the burden of demonstrating that suspended rates are lawful. *See, e.g., In the Matter of Annual 1990 Access Tariff Filings*, Memorandum Opinion and Order, 5 FCC Rcd 7487 (1990); *In the Matter of Investigation of Special Access Tariffs of Local Exchange Carriers*, Memorandum Opinion and Order, 63 RR2d 362 (1987).

^{8/} Direct Case, Introduction and Summary at 2-3.

preferable, then the Commission certainly can prescribe a different methodology in the context of a tariff investigation.^{9/} Indeed, this critical examination of various cost allocation methodologies is particularly appropriate here as the Commission deferred addressing cost allocation issues during rulemaking and Section 214 proceedings on the ground that these issues were better addressed in the context of a tariff proceeding.

Adelphia first raised concerns about Bell Atlantic's allocation of common costs almost three years ago, in opposing its Section 214 application for Dover.^{10/} At that stage, the Commission deferred the cost allocation question until the tariff review process, thereby enabling Bell Atlantic to build facilities without any assurance that it will be able to generate sufficient revenue to recover a reasonable portion of the common costs of the system.^{11/} Not surprisingly, Bell Atlantic now seeks the Commission's blessing for a tariff that would force telephone customers to pay virtually the entire cost of the facility except for those few costs dedicated solely to video dialtone.

^{9/} For example, in reviewing LEC virtual collocation tariffs, the Commission determined that most LECs, including Bell Atlantic, proposed to recover an unreasonable share of overhead and directed them to recalculate their rates using a formula prescribed by the Commission. See *In the Matter of Ameritech Operating Companies Revisions to Tariff F.C.C. No. 2 et.al*, Order, 10 FCC Rcd 1960 (1994) ("*Virtual Collocation Suspension Order*"); *Local Exchange Carriers' Rates Terms and Conditions for Expanded Interconnection Through Virtual Collocation for Special Access and Switched Transport*, 10 FCC Rcd 6375, 6413 (1995).

^{10/} "At a minimum, the standards for cost allocation should be the same as those for enhanced services, because the risk of cross-subsidization and misallocation are at least as great." Petition to Deny at 23.

^{11/} *Dover Order*, 9 FCC Rcd at 3683-84.

Without doubt, the Commission has the discretion within a tariff investigation proceeding to prescribe under Section 205(a), 47 C.F.R. § 205(a), rates and/or methodologies that were not proposed by the carrier. This is exactly what the Commission should do here. This is the *first* tariff proceeding in which the issues surrounding video dialtone cost allocations will be addressed and the Commission *must* establish cost allocation principles that can be applied to all video dialtone carriers as it stated it would.^{12/} This prescription of cost allocation procedures will benefit all interested parties by establishing certainty as to the allocation procedures to be employed by LECs and minimizing the need for burdensome tariff investigations each time a carrier proposes a new cost allocation scheme. More importantly, it will ensure that telephone ratepayers are not forced to subsidize LEC entry into the video market.

III. BELL ATLANTIC'S PROPOSED COMMON COST ALLOCATION IS UNREASONABLE AND UNLAWFUL BECAUSE IT PLACES A BURDEN ON TELEPHONE RATEPAYERS FAR IN EXCESS OF ANY BENEFIT THEY RECEIVE.

To guard against the substantial risk of cross-subsidization presented by video dialtone, the Commission has required LEC video dialtone tariffs to demonstrate recovery of all dedicated video costs plus a reasonable portion of common costs.^{13/} Under Bell Atlantic's proposed tariff, common costs would be allocated in proportion to the ratio of dedicated

^{12/} In the *Video Dialtone Reconsideration Order*, the Commission declined to adopt video dialtone specific allocation rules because the "first few tariff proceedings will provide a far more concrete and realistic factual context for future decision making." *Video Dialtone Reconsideration Order*, 10 FCC Rcd at 340.

^{13/} *Id.* at 345.

telephone costs to dedicated video costs, which Bell Atlantic claims will result in 72 percent of common costs being allocated to telephone services and 28 percent to video dialtone.

In the *Suspension Order*, the Commission found that this allocation raised substantial questions of lawfulness.^{14/} The Commission recognized immediately that using the ratio of dedicated telephone investment to dedicated video investment to allocate common costs would give carriers an incentive to design facilities that contained substantial dedicated telephone investment and minimal dedicated video investment.^{15/} Indeed, in an extreme case, if a LEC rebuilt its facilities so that all video investment was shared, none of the shared costs would be allocated to video. Accordingly, Issue C of the *Investigation Order* asked whether Bell Atlantic's proposed allocation methodology was reasonable and whether it advanced the Commission's video dialtone goals.^{16/}

In its Direct Case, Bell Atlantic argues that its proposed allocation is reasonable because this network upgrade is merely the latest step in the evolution of the telephone network.^{17/} As shown by Dr. Johnson, this position is totally unsupportable because the

^{14/} *Bell Atlantic Telephone Cos. (Revisions to Tariff F.C.C. No. 10)*, Transmittal Nos. 741, 786, Order, DA 95-1285 at ¶ 33 (rel. June 9, 1995) ("*Suspension Order*").

^{15/} *Id.*

^{16/} *Bell Atlantic Telephone Cos. (Revisions to Tariff F.C.C. No. 10)*, CC Docket No. 95-145, Order Designating Issues for Investigation, DA 95-1928 at ¶ 23 (rel. September 8, 1995) ("*Investigation Order*").

^{17/} Direct Case at 39-40.

investment allocated to telephone services far exceeds the cost of facilities necessary to provide telephone service, *even if an entirely new telephone network were constructed.*^{18/}

Bell Atlantic argues that the proposed allocation is reasonable nevertheless because video dialtone could not support a higher allocation. Clearly, however, this shows only that Bell Atlantic has made an uneconomic investment, not that telephone customers should foot the bill for it.

A. The Tariff Demonstrates That the Dover Video Dialtone Service Is an Unworkable Business Proposition That Bell Atlantic Would Have Telephone Customers Finance.

From the outset, substantial concerns have been raised about Bell Atlantic's ability to recover the cost of the Dover network from video dialtone service. Adelphia demonstrated in its Petition to Deny the Section 214 application and its Petition to Reject the tariff that it would be virtually impossible for Bell Atlantic to generate sufficient revenue from programmers to recover the substantial cost of the Dover facility.^{19/} Bell Atlantic's new "elasticity" showing confirms Adelphia's arguments. According to Bell Atlantic, its video dialtone business will be viable at the proposed rates (which do *not* cover all relevant costs),

^{18/} "Bell Atlantic proposes to charge telephony \$1191 per potential subscriber, compared to a stand-alone cost for a new narrowband (digital loop carrier) network that might cost in the neighborhood of \$700." Johnson Declaration at 15.

^{19/} Petition to Deny at 23; Petition to Reject at 14.

but *only* at the proposed rates.^{20/} At higher rates that are necessary to avoid cross-subsidy, it claims it will generate less revenue and not be able to recover its costs.^{21/}

Thus, apparently hoping that the Commission will abandon its statutory obligation to protect ratepayers in order to facilitate infrastructure investment, Bell Atlantic presents the Commission with a Hobson's choice between video dialtone paid for by telephone ratepayers or no video dialtone at all. However, the Commission's desire to promote infrastructure investment does not mean that it should not distinguish between sound investments and wasteful ones.

As described by Dr. Johnson, the fiber-to-the-curb network Bell Atlantic is building in Dover is not the only way in which it could have upgraded its Dover facility. Dr. Johnson demonstrates that less expensive upgrades of the telephone network would have produced the *same* benefits for telephone customers that they purportedly receive from the fiber-to-the-curb network.^{22/} Consequently, there is no reason why telephone ratepayers should be forced to cover any amount in excess of the cost of these less expensive alternatives.

The fact that Bell Atlantic already has spent millions on the Dover facility should not enter into the Commission's decision as to how these costs should be allocated and from

^{20/} Direct Case, Exhibit B, Affidavit of Robert J. Rider ("Rider Affidavit") at 5-7.

^{21/} *Id.*

^{22/} "Although Bell Atlantic argues that its integrated network will offer narrowband services in addition to those on a stand-alone telephone network . . . the company has been evasive and vague about the nature of such services, and why they cannot be adequately provided on a new telephone stand-alone network or, indeed, why they cannot be provided even on the existing telephone network." Johnson Declaration at 15.

whom they are recovered. Bell Atlantic knew when it began construction that the Commission had not approved its cost allocation proposal and that the Commission might prescribe a less favorable allocation. These risks must be borne by Bell Atlantic's shareholders, not its ratepayers. The Commission is not in the business of propping up new ventures that would not be viable but for cross-subsidization at the expense of captive ratepayers.

B. Bell Atlantic has Failed to Demonstrate Why the Bulk of Shared Costs Should Not Be Recovered from Video Dialtone.

In deciding to apply the price cap new services test to video dialtone tariffs, the Commission recognized that "incremental" costs encompass more than just dedicated costs and must include a reasonable portion of common costs.^{23/} The question, therefore, is what constitutes a "reasonable" allocation of common costs between video and telephone services. As described in the Johnson Declaration, the costs allocated to telephone services should reflect the benefit received by telephone customers. Thus, if a brand new telephone network costing \$700 per subscriber would provide the same benefits to telephone customers as the fiber-to-the-curb network Bell Atlantic is building in Dover, then the \$1200 per subscriber Bell Atlantic proposes to allocate to telephone services is at least \$500 too high.^{24/}

This is a critical point that has been completely ignored by Bell Atlantic in its filings. While Bell Atlantic has alluded to benefits telephone customers will receive from the fiber-to-

^{23/} *Video Dialtone Reconsideration Order*, 10 FCC Rcd at 345.

^{24/} *Johnson Declaration* at 15.

the-curb network in Dover, such as new services, *nowhere* has it explained, let alone quantified, how these benefits exceed what telephone customers would receive from less substantial modifications to the network. Indeed, as shown by Dr. Johnson, the "new" services listed by Bell Atlantic all can be provided over the existing telephone network.^{25/}

In deciding the appropriate allocation of common costs, the Commission should consider the policies established by other jurisdictions that have addressed the same question. The Canadian Radio and Television Commission, for example, recently established the principle that costs of LEC network rebuilds should presumptively be assigned to competitive services. As stated by the CRTC:

The Commission finds that, in general, the most appropriate regulatory treatment for broadband initiatives is to require the telephone companies to assign to the Competitive segment all new investments and related expenses associated with the deployment of fibre, coaxial cable, opto-electrical equipment, asynchronous transfer mode switches, and video servers.^{26/}

The Connecticut Department of Public Utility Control also has recognized that methodologies in which the bulk of common costs are assigned to telephone services are unreasonable. In reviewing a proposal by the Southern New England Telephone Company to allocate common costs based on the ratio of video lines to telephone and video lines, the DPUC stated:

^{25/} *Id.* at 14-15. Moreover, nowhere does Bell Atlantic disclose the additional costs that must be incurred to provide some of these services over the fiber-to-the-curb network.

^{26/} *Implementation of Regulatory Framework - Splitting of the Rate Base and Related Issues*, Canadian Radio-television and Telecommunications Commission, Telecom Decision CRTC 95-21 (October 31, 1995).

[T]he Company's proposed . . . cost allocation will lead to basic telephone service subscribers bearing most of these costs, based on allocation and direct assignment techniques that have little relationship to the reasons why these costs were incurred.

Moreover, the allocation of costs based simply on the number of fibers dedicated to services fails to recognize that . . . the entire benefit of the cable is the additional capacity and this high capacity is not needed for basic voice communications.^{27/}

These agencies have recognized that the motivating factor for LEC network rebuilds is the provision of video services and that LECs should be required to justify the allocation of any of these costs to non-competitive telephone services. The Johnson Declaration demonstrates that Bell Atlantic has not offered any valid reason why the same presumption should not apply here. The costs Bell Atlantic proposes to allocate to telephone services are far in excess of what would be required to build an entirely new telephone network. Thus, it is plain that Bell Atlantic's proposal is unreasonable and that the Commission must prescribe an allocation methodology that more accurately reflects the fact that entry into the video market was the motivating factor for Bell Atlantic's investment.

^{27/} *Application of Southern New England Telephone Company for Approval to Conduct a Video Dial Tone Transport and Switching Trial*, Docket No. 95-03-10, Decision at 12 (Ct. DPUC June 30, 1995).

IV. BELL ATLANTIC'S PROPOSED OVERHEAD LOADING IS UNREASONABLE BECAUSE IT FAILS TO REFLECT THE INCREASE IN OVERHEAD COSTS ATTRIBUTABLE TO VIDEO DIALTONE.

In the *Video Dialtone Reconsideration Order*, the Commission stated that it would require a strong justification for extremely low overhead allocations.^{28/} In the *Suspension Order*, the Commission found immediately that Bell Atlantic's overall overhead loading factor of 1.2 (*i.e.*, 20 cents of overhead for each dollar of video dialtone investment) and its 1.06 loading factor for term and volume discounts were low enough to warrant investigation.^{29/} Therefore, Issue E of the *Investigation Order* requested that Bell Atlantic justify its overall loading factor and Issue F required a justification for the loading applicable to term and volume discounts.^{30/}

In its direct case, Bell Atlantic has not provided the required justifications for its extremely low overhead allocation. As an initial matter, Bell Atlantic's claim that it will recover 20 percent of overhead is erroneous. Bell Atlantic's projected 20 percent contribution to overhead recovery is based on its flawed allocation of direct costs. If an allocation that assigns more common costs to video is substituted for the 72/28 allocation proposed by Bell Atlantic, projected revenues from video dialtone would make an even smaller contribution to overhead.

^{28/} *Video Dialtone Reconsideration Order*, 10 FCC Rcd at 346.

^{29/} *Suspension Order* at ¶ 48.

^{30/} *Investigation Order* at ¶¶ 34-36.

Furthermore, even if the Commission does not require a different allocation of direct costs, there is no basis for permitting the unreasonably low overhead loading factor of 1.2. As described below, Bell Atlantic's proposal fails to reflect the additional overhead costs that will be generated by video dialtone and attempts, instead, to shift these costs to customers of non-competitive telephone services. The Commission cannot countenance this blatantly anticompetitive approach and must instead require Bell Atlantic to recover, at the least, the additional overhead costs that will be generated by its video dialtone investment.

A. Bell Atlantic's Proposed Overhead Loading Does Not Reflect the Fact that Overhead Costs Are Variable, Not Fixed.

In its Direct Case, Bell Atlantic states that "customers of other telephone services are by definition better off with *any* contribution to overhead borne by this new service."^{31/} By requiring LEC video dialtone tariffs to demonstrate a reasonable recovery of overhead, and by investigating the lawfulness of this tariff, the Commission already has rejected this conclusion. Moreover, contrary to Bell Atlantic's assertion, telephone customers are not better off with any contribution to overhead borne by video dialtone. Rather, as explained by Dr. Johnson, telephone customers are better off *only* if video dialtone recovers the overhead expense generated by Bell Atlantic's decision to provide video dialtone.^{32/}

^{31/} Direct Case at 62, n.54.

^{32/} "The increase in overhead caused by a service expansion is properly regarded as an incremental cost of that expansion, no different from the principle of cost causation that underlies the estimation of other incremental costs." Johnson Declaration at 22.

Just as Bell Atlantic equates dedicated equipment costs with incremental costs, so does it equate overhead costs with fixed costs. If overhead costs were fixed, that is, unchanged in spite of increases in direct costs, the failure of video dialtone revenues to cover overhead costs would not be a matter of substantial concern. As shown by Dr. Johnson, however, overhead costs are variable, not fixed.^{33/} Thus, rather than treating overhead as a common cost to be allocated among all a carrier's services, the Commission must recognize that the increase in direct costs attributable to video dialtone will result in a corresponding increase in expenses equal to approximately 65 cents for each dollar of direct cost.^{34/}

A requirement that Bell Atlantic reflect these costs in its video dialtone rates is not a requirement that it offer service at fully allocated costs, but rather a recognition that additional costs will be incurred that would not be incurred but for the offering of video dialtone. It would not be possible to build and operate an entirely new digital network without incurring additional overhead expense. While some of these new overhead costs may be attributable to both telephone and video services, many are a direct result of Bell Atlantic's decision to provide video dialtone.^{35/} Unless customers of Bell Atlantic's video

^{33/} "In Dr. Taylor's words, 'by definition, overhead expenses do not change when a new service is initiated or the volume of a service is increased.' Nonsense. The items Bell Atlantic lists as overhead clearly do change with the number and volume of services." *Id.* at 20.

^{34/} "My emphasis on a 65 percent loading reflects only the fact that each dollar of video dialtone direct costs generates (again as an approximation) about 65 cents in overhead, which is properly regarded as an *incremental* cost of video, *not* as a fixed shared or common cost to be allocated in some arbitrary fashion among all services." *Id.* at 25.

^{35/} For example, Bell Atlantic acknowledges that start-up costs for video dialtone were not directly assigned to Dover, but instead are included in general overhead. Direct Case at 61.

service bear this additional overhead expense, telephone customers most definitely will not be better off than they would be if video dialtone were not offered.

B. Bell Atlantic's Proposed Overhead Loading Does Not Reflect the Fact that Video Dialtone Will Incur More Overhead than a New Telephone Service.

As shown above, the addition of video dialtone investments and direct expenses is certain to cause at least a proportionate increase in each category of overhead costs. In all likelihood, however, this understates the overhead that will be generated by video dialtone. There is good reason to believe that video dialtone service will cause a proportionately greater increase in overhead costs than a new telephone service. For example, Customer Operations expense will certainly be greater for a service that is new to both Bell Atlantic and its customers. The development of new marketing plans, organizations, and operations and new customer service relationships will incur expenses proportionately greater for video dialtone than for established telephone services. Bell Atlantic's claim that marketing video dialtone will be no different than marketing a new access service to IXCs ignores its complete lack of experience in the video programming market.

Bell Atlantic's argument that any substantial additional costs that might be incurred would be treated as direct costs of providing video dialtone, rather than overhead, is unconvincing.^{36/} Bell Atlantic states in D(6) that "start-up costs are appropriately recovered through overheads cumulatively applied to all services."^{37/} Indeed, while Bell Atlantic

^{36/} *Id.* at 63.

^{37/} *Id.* at 61.

acknowledges in D(4) and D(5) that there are costs attributable to video dialtone, it proposes to treat these costs as general overhead (allocable to telephone services) because they are not specifically identified with Dover.^{38/} Given Bell Atlantic's desire to place as many costs as possible in overhead, rather than assigning them directly, the Commission must require a greater allocation of overhead to video dialtone than the meager 20 percent proposed here.

Bell Atlantic's attempt to include the bare minimum of overhead in video dialtone rates stands in stark contrast to its attempt to price expanded interconnection service at fully allocated cost. Although expanded interconnection involved a relatively minimal investment in existing technology, Bell Atlantic argued that it was appropriate to include a 65 percent loading factor.^{39/} Bell Atlantic's inconsistent insistence on high overhead loadings in that case and a relatively minimal one here is a blatant attempt to shift video dialtone costs to telephone services. The Commission must reject this blatantly anticompetitive proposal and require Bell Atlantic's video dialtone rates to reflect the fact that it will incur overhead equal to approximately 65 percent of its direct costs.

^{38/} For example, even though video dialtone is an entirely new service for Bell Atlantic, it identifies only \$19.37 for Research and Development and \$19.37 for Planning as direct expenses for Dover. The remainder of these costs have been allocated to general overhead. Direct Case, Attachment D(3) at 1.

^{39/} "Bell Atlantic, for example, proposes to assign loadings of 65 percent to collocation recurring charges while assigning loadings as low as 23 percent to the comparable services." *Virtual Collocation Suspension Order*, 10 FCC Rcd at 1973.

V. PRICE CAP RULES ARE NOT ADEQUATE TO PREVENT BELL ATLANTIC FROM SHIFTING THE BURDEN OF THE DOVER INVESTMENT TO TELEPHONE RATEPAYERS.

Bell Atlantic previously has stated that "in the pure price cap regulatory environment by which Bell Atlantic recently elected to be governed, there is no possibility that Bell Atlantic could raise prices of other regulated services to subsidize below cost rates for video dialtone service.^{40/} As explained in the Johnson Declaration, reliance on price cap rules to prevent cross-subsidization is totally unfounded. The key flaw in Bell Atlantic's analysis is its failure to recognize that a primary function of price caps is to give ratepayers the benefits of productivity through rate reductions. Even if Bell Atlantic is correct that it cannot raise rates for regulated services, *it cannot deny that it can manipulate cost allocations to avoid reducing rates as much as otherwise would be required.* This type of behavior constitutes cross-subsidization just as much as cost shifting that results in rate increases.

Bell Atlantic has both the incentive and the ability to misallocate costs is because state and federal price cap rules do not completely decouple costs and rates. Dr. Johnson explains that under the New Jersey plan, Bell Atlantic's costs affect its rates for regulated services in three ways. First, Bell Atlantic is not required to reduce rates to reflect productivity in any year in which its rate of return is less than 11.7 percent. Consequently, if Bell Atlantic shifts video costs to telephony and reduces its rate of return below 11.7 percent, it can avoid taking rate reductions that otherwise would be required. Second, shifting costs from video to telephone services will enable Bell Atlantic to avoid the sharing requirement that is triggered

^{40/} *Bell Atlantic Telephone Cos. (Revisions to Tariff F.C.C. No. 10)*, Reply of Bell Atlantic at 2 (filed May 19, 1995).

if its rate of return exceeds 13.7 percent. Finally, by shifting costs to telephone services, Bell Atlantic reduces the productivity of these services, which will lead to adoption of a lower productivity factor when the plan is reviewed in 1999.^{41/}

The Commission's price cap rules suffer from similar flaws. While Bell Atlantic has elected a "no-sharing" option this year, it can make a different election in subsequent years. Thus, in years when it anticipates a rate of return that would not trigger sharing, Bell Atlantic can opt for a lower productivity factor. Furthermore, the Commission price cap regime is subject to formal review every four years. Consequently, to the extent Bell Atlantic reduces its productivity through misallocation of video costs to telephony, its productivity factor in future years will be reduced.^{42/}

Thus, Bell Atlantic's costs continue to play a role in the calculation of Bell Atlantic's telephone rates and the opportunity for cross-subsidization still exists. Given the existence of this opportunity, and the substantial pay-off to Bell Atlantic in the video market if it can successfully take advantage of this opportunity, the Commission must make the correct policy decision with regard to cost allocations. Only by prescribing a reasonable methodology for the allocation of common costs and overhead can the Commission ensure that telephone ratepayers do not foot the bill for Bell Atlantic's uneconomic investment in Dover.

^{41/} Johnson Declaration at 32.

^{42/} *Id.* at 33.

VI. THE COMMISSION MUST REQUIRE BELL ATLANTIC TO CHARGE A HIGHER RATE FOR VIDEO DIALTONE SERVICE.

In the *Video Dialtone Reconsideration Order*, the Commission established standards for LEC video dialtone tariffs. The Commission found that stringent application of the price cap new services test was necessary to counter the LECs obvious incentive to price video dialtone at artificially low rates.^{43/} As described above, Adelphia has demonstrated that Bell Atlantic failed to satisfy the new services test. Accordingly, Bell Atlantic must be required to charge a rate that reflects a reasonable sharing of common costs and a more realistic overhead loading.

This proceeding presents the Commission with its *first* opportunity to apply the new services test to a commercial video dialtone offering. Failure to require Bell Atlantic to amend its tariff will lead to even more egregious abuses in future tariff filings as LECs seek to enter new markets while minimizing the risk to their shareholders. The Commission cannot look at Dover in a vacuum. It must consider the substantial impact this decision will have on future LEC investments and the uneconomic investments that will result if LEC shareholders are immunized from the risks of entering the video market.

Bell Atlantic argues that it would lose all its customers for the Dover video dialtone service if it were forced to use allocation procedures that would result in higher rates. In

^{43/} *Video Dialtone Reconsideration Order*, 10 FCC Rcd at 344-45.